A PERSONALIZED, INDEPENDENT, PRO-ACTIVE WEALTH MAMANGEMENT FIRM

# RealGrowth Investment Counsel

SINCE 1981 NOVEMBER 2023

## Our Current Stance

**EQUITIES:** At first blush, with the potential for wider wars, a reasonable person might wonder why the markets haven't fallen more. Combined with this and all of the intense feelings in many countries around the world, the markets still don't seem worried.

> **Tax Free Savings Account (TFSA)**
>
> **2023 TFSA Contribution: $6,500**
>
> **Cumulative Contribution** 2009 - 2023: **$88,000**

The reasons are that markets are big voting machines, they are neither emotional nor moral. Theoretically markets take in all of the information from everywhere, the effects on earnings and potential for growth, or not, are taken into account and that is where the markets are priced. As individuals we see a fraction of those variables, we are emotional, and thus are influenced by the opinions we hear from the media and our experiences.

To be good investors, we have to look at the markets and follow its lead, not the other way around. Should the markets be concerned about the potential for a wider war, yes absolutely! However, according to the markets, that eventuality doesn't seem to be a likely outcome, at least for the next 6 months from today.

We wouldn't be doing our job, however, if we weren't watching world events, along with the commensurate market reactions. The moment we see potential trouble ahead we will react. In the meantime, we've taken a conservative position and placed the cash that has built up in the portfolios from excellent dividends into very safe government short-term liquid bonds.

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## Month in Review

**TO OUR CLIENTS**: Looking forward: As we all know, the world seems less stable these days, and we are all wondering how that may affect the stock markets.

The markets don't have emotions and, as such, don't have a moral compass. What they do consider, however, is whether or not oil prices will rise, what will happen to interest rates and how both and other variables will affect profit margins. It's a very dry collective calculation about the effect on margins and earnings. The war in the Middle East on its own doesn't matter as much as whether oil supplies will be affected and, if so, what will happen to borrowing costs. Or, if Iran et al were successful in driving out Western influence from the area, would that affect the power base of the United States in world affairs. In all likelihood, that eventuality would affect the value of the U.S. dollar and how much influence western businesses would have on trade. If the dollar were to fall in value, would interest rates have to rise to compensate the lenders for the loss of purchasing power? Of course, higher interest rates would raise the cost of doing business and thus earnings could fall.

Although the markets are not down too much on the year, not what you would think with all of the geopolitical instability around the world, the majority of underlying stocks are not doing well and as such the overall markets are in an unhealthy position. The general markets are not broadly based because there is a valuation disparity between very large companies that have a greater relative weighting in the way the markets are priced than the broader spectrum that better represents the reality of the economy. For example, two companies, Apple & Microsoft, are worth more than all of the energy, real estate, utilities and materials sectors combined.

We reason that, in this environment especially, the Federal Reserve's ("Fed") "higher for longer" stance is unsustainable as it will trigger a general credit deflationary spiral and a steep "election-year" recession.

The precarious U.S. fiscal situation (massive debts and annual deficits and funding both) has received only token attention for many years but is now mentioned prominently in the financial

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### CLOSING STOCK MARKET AVERAGES AS AT MONTH END

| | 31/10/2023 | 30/09/2023 | Change (1 Month) | Change (Dec 31/22) |
|---|---|---|---|---|
| Dow Jones Industrial Average (DJ) | 33,052.87 | 33,507.5 | (1.36%) | (0.28%) |
| Standard & Poor's 500 | 4,507.66 | 4,588.96 | (1.77%) | 17.40% |
| NASDAQ | 14,034.97 | 14,346.02 | (2.17%) | 34.09% |
| Toronto Stock Exchange | 20,292.60 | 20,626.60 | (1.62%) | 4.68% |
| London FT100 | 7,439.10 | 7,699.40 | (3.38%) | (0.17%) |
| USD/CAD $ | 1.3535¢ | 1.3250¢ | (2.11%) | 0.12% |
| EUR/CAD $ | 1.4801¢ | 1.4609¢ | (1.30%) | (2.39%) |
| Natural Gas | 2.77 | 2.63 | 5.09% | (38.15%) |
| Oil West Texas | $83.63 | $81.80 | 2.24% | 4.20% |
| Gold | $1,938.20 | $1,970.50 | (1.64%) | 6.51% |

## Our Current Stance

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**INFLATION:** In our opinion, inflation is just as much a supply issue as a demand one. By using the only tool that the Western Federal Reserve Banks have, raising interest rates, they are only affecting the demand side of the equation. Rising interest rates is stifling supplies and because demand is still there, inflation is becoming more entrenched into the system. If the war in the Middle East does intensify, including oil producing countries, and oil prices rise (due to decreased supplies) then a recession will occur at the same time as rising inflation. In all likelihood, the governments will respond by printing more money to prevent a recession and then a devaluing currency will cause lenders to demand higher interest rates to be compensated for a less valuable currency.

**FIAT CURRENCIES:** The handwriting is on the wall. Fiat currencies are falling in value relative to hard assets. It's not a sudden response but something that has been brewing for many years. To protect investments at least a portion of a portfolio should be in hard assets. In fact, looking at long-term charts industries such as commodities have a long way to go on the upside to come back to a normal level relative to financial assets. They could surpass as the pendulum can swing further the other way. So, no matter how you look at the various economic (social/political) scenarios, such as higher demand or the opposite being a recession, commodities are likely to rise in value.

**INTEREST RATES:** The world right now is experiencing a broad-based bear market in the bonds space. In fact, this is the longest, bear market in bonds in modern history! Meanwhile, the stock market has held up quite well. How is that possible?

Right off, the stock market seems completely detached from any kind of reality.

Things that should be important, like a company's PE ratios, forward guidance,

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*First Home Savings Account (FHSA) - IS HERE!*

*One of the newest tax breaks available - FHSA - we will be able to open for our Clients as of Nov. 20th, 2023.*

*1) Annual contributions to an FHSA can be up to $8,000, with a lifetime max. contribution of $40,000.*

*2) Contributions can be claimed as a deduction against taxable income. Investments grow in the account without being subject to tax.*

*3) Income and withdrawals aren't taxable, if they are used for a home purchase. No repayment is required on withdrawals.*

*4) Withdrawals not made to purchase a qualifying home are taxable income. HOWEVER, if the clients decide to use the funds for something else, they can transfer the money to an RRSP or RRIF without affecting their contribution room.*

*By taking advantage of both the FHSA and the Home Buyers Plan (which allows to withdraw up to $35,000 from an RRSP tax-free for a home purchase) the Client could save up to $75,000 to use toward a first home, plus any growth in the FHSA.*

## Month in Review

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media. The scale and trajectory of rising U.S. borrowing needs, and absence of any political corrective action, are threatening markets and the economy in ways that they haven't for a generation.

And, from Kevin Warsh, former Fed Governor (WSJ 10/6/23): "The U.S. is courting trouble. The federal government is 43% larger than it was four years ago, and its reach is expanding mightily. More than a third of the surge in investment spending can be traced to government subsidies, credits and handouts…"

The coming supply of Treasury securities required to fund U.S. government deficits will likely be substantially larger than official estimates. And purchasers of Treasury debt will demand higher yields, at least until something breaks in the economy.

"First, on the supply side. The government currently funds almost $34 trillion of outstanding debt at an average interest rate of about 2.9%. That doesn't include the unfunded future obligations……. If the Fed's recent rosy economic forecasts for growth and inflation are wrong and a recession ensues, there will be a gusher of new debt. Every additional 1-point increase in interest rates will add more than $2.5 trillion in expense in the next decade.

Next, on the demand side. After the global financial crisis, four of the largest purchasers of Treasury debt were price insensitive. That is, they were buying Treasury debt for policy reasons — economic, geopolitical or regulatory. Price didn't matter. How fortunate. These buyers, however, have largely exited the market. The Fed bought about a quarter of all Treasury debt in the past decade but warns that its Treasury holdings will shrink for at least another year.

China, another massive buyer in recent years, is unlikely to sell its existing holdings at a loss. But don't expect Chinese leadership to do the U.S. any favors by showing up in size at the next Treasury auction. …… And after the banking debacle in March catalyzed by Silicon Valley Bank, the largest banks — firmly overseen by their regulators — are no longer keen to load up on 'risk-free' long-dated Treasury bonds."

**DEBT**: The numbers below are almost meaningless to everyone. No one should feel badly about not understanding what they mean, because they are fundamentally incomprehensible.

One can ask, what does a trillion dollars mean? 1 trillion seconds have passed since cave dwellers painted their hands on cave walls.

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## Our Current Stance

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cash flow, etc., no longer seem to matter. The market has become so used to easy money and easy credit, that overall, the stock market is somewhere off, beyond normal risk aversion.

The recent selloff in the debt market has pushed some risk in this market to, however, even with that the stock market has held up well.

One reason for the market's relative strength may be due to recent geopolitical events, more specifically rapidly expanding war, and its associated funding/ support etc., to the tune of HUNDREDS OF BILLIONS of dollars, soon to be much more, has certainly given a major boost to U.S. GDP. It has also set the stage for much higher inflation.

It is certainly no secret that war, along with the expansion and propagation of war, is stock market positive. War fuels the Military Industrial Complex, which is often described as the relationship between a countries' military and the defense industry that supplies it.

But where does all this cash come from? No other endeavor on Earth generates a greater need for borrowed dollars than war. No developed nation on the planet has a "war chest."

So again… where does the cash come from to fight wars? Its central banks are printing money and lending it to its own government!

**OIL/GAS AND COMMODITIES:** Gold, silver and general raw commodity prices were solidly lower in early November trading, following weaker-than-expected economic data out of China that has cast a pall over much of the raw commodity sector.

The latest economic data out of the world's second-largest economy saw China's October exports fall 6.4%, year-on-year, which was lower than expected.

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## Month in Review

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The size and scale of the known universe (what we can see in a potentially infinite universe(s)) is made up of one trillion galaxies. Each galaxy has roughly 400 billion stars. It takes light about 100,000 "years" to cross our Milky Way galaxy (average size).

Paying off the U.S. debt alone (not counting the future unfunded obligations) would mean about $106,000 each for every man, woman and child in the U.S. Ok, how about those folks with assets over 1 million dollars. That would mean about $15.3 million dollars for each of them. There is only one palatable way (war is not palatable) to pay off that debt, and it is called inflation, the devaluation of fiat money.

**ECONOMICS**: Once the engine of European growth, Germany remains the economic drag on Europe. They reported industrial production in September that fell 1.4% m/o/m vs the estimate of little change. Lower production of autos, electronics and pharma led the way. This follows a slightly weaker than anticipated factory order number reported in early November.

Overseas, a key driver of when the BoJ will exit printing money, with no end in sight, will be the wage story, which they desperately need to see lift in the face of higher inflation. Regular base pay in September rose 1.5% y/o/y, more than half the rise in inflation but still is just off the fastest print seen in May since 1997.

The IT marketplace, an area that has seen once bullet proof high price to earnings multiples, has started to decline from unsustainably high levels. The uncertain market conditions they've operated under throughout the year seem to be continuing and are leading to customer caution and practicality. Given this, we expect that the IT market will contract but remain at the upper end of high single digits.

Other areas of the economy could be slowing down as well, but we are watching the trends of earnings as they are reported. Certainly interest rates around the world have risen dramatically over the past 4 years (as can be seen in the chart below) and, subject to earnings growth, we would have to see a sustained drop before any kind of sustained market upturn could happen.


**CONCLUSION**: The markets don't seem to be as concerned about the future earnings of corporations and the economy, the ability of governments to fund their debts and deficits, or for the potential of world-wide social unrest and wider conflict between competing powers to the west, as one might think.

That doesn't mean that we shouldn't be concerned. As long-term and value investors, it would be imprudent not to be warry of any one of those events tipping the world into a recession, or worse.

As such, we remain more thoughtful than usual. Although we haven't sold any of our core positions, we've kept our powder fairly dry by buying secure and liquid government bonds with excess cash. The risk/reward, of being fully invested, is just a bit too skewed for us towards the risk side of the equation at this time and will remain cautious until after the new year.

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China's imports rose a less-than-expected 3.0%, year-on-year. China is a massive consumer of raw commodities and when its economy is not doing well, on weakening demand concerns, it dampens bullish enthusiasm across the raw commodity market field.

Australia's central bank raised its main interest rate by 0.25% to 4.35% on November 7th, saying inflation is still too high. The central bank had gone four monetary policy meetings in a row with a pause. It was reported that the Reserve Bank of Australia's rate hike to crack down on inflation was a surprise and may be a precursor to what the U.S. central bank may have to do in the coming months. The Wall Street Journal reported the night before that Minneapolis Fed official Neel Kashkari said he is not convinced U.S. interest rate hikes are done and said he would rather err on side of overtightening. This news also falls into the camp of the metals market bears and reflected in the weakening prices. We will see how this plays out but weary that an economic downturn may not have even started and increases in rates would be a tough pill to swallow for many western governments.

**PRECIOUS METALS:** Recent reports from the World Gold Council says central bank gold-buying surged to 800 tons in the first nine months of this year and could hit a record in 2023. If the central bankers are indeed the so-called "smart money" in the marketplace, then the retail gold bulls should be feeling pretty good.

Rising prices of precious metals is, however, not something that western governments want to be seen. That is because it exposes the planned devaluation of fiat currencies to help pay for the ever-increasing levels of debts and deficits. There is no other pill than inflation to cover their debts that the world will be able to swallow.

So, precious metals will continue to rise but it will be like climbing a wall of worry. There will be periods of prices rising slowly interrupted by moments of hard pullbacks. Timing is just too difficult, so we maintain a core position at most times. That strategy has paid off more times than I can count and suspect it will help mitigate any downturns sometime in the near future.

# Political Shorts

## A Clear Shift in Direction

Argentina election polls are showing an increasingly tight race between Liberal Peronist economy minister Sergio Massa and radical libertarian Javier Milei ahead of a runoff ballot on Nov. 19. We may know the result of the election by the time this is printed. However, what matters is the changes going on in Latin America and elsewhere.

The two candidates offer polarized visions for the besieged Latin American country, the region's third largest economy, a major supplier of grains, beef and lithium, which is also the largest debtor to the International Monetary Fund (IMF). For a generation, western conglomerates have taken those resources and kept a majority of the profits, leaving Argentina and many countries like it, with little to show for its populace.

With the rise of competing powers to the west, the populace is looking to profit from their resources by doing business with the east. This is causing a rift within the population, and away from traditional methods of doing business. The political arena is reacting to this shift and the rift seems to be spreading.

Milei, a self-described anarcho-capitalist who says that he is like past U.S. president Donald Trump, built a groundswell of support while calling for elimination of the Central Bank, replacement of the local currency with the U.S. dollar, and a purge of the corrupt establishment that he called the "political caste." Taking on the U.S. dollar would, in our opinion, be catastrophic for their economy but the many voters seem to be basing their decisions on bits and bytes from social media and not history.

Massa focused much of his firepower in the campaign's final days on warning voters against backing Milei, painting him as a dangerous upstart. He argued that Milei's plans could have devastating effects on social welfare programs, education and health care. The health, education and social development ministries are among those Milei wants to extinguish.

This is not the only example of changes happening around the world. When did it happen that Russia felt strong enough to invade Ukraine? When did Hamas decide that they would be able to get away with attacking Israel? In order to quell any potential widening of the war between Israel and Palestine (Hamas), the U.S. has had to send their best naval vessels into the middle-east. In the past their words would have been enough. Biden, on his emergency visit to the middle-east was shunned by the Palestinian leader and other leaders surrounding Israel. That's certainly seems like a new development.

The markets' ongoing reaction to this world-wide and growing power shift remains in flux and will certainly cause increased volatility. However, what is clear is that the hegemony of the U.S. dollar will continue to wane over the next few decades. By having the U.S. dollar as the world's reserve currency the west has, for a generation, had the strength to project its military and political power and with that grow its economic supremacy.

Those areas of the marketplace that will benefit from these changes will do well and those that have benefited from past influence may not. It's going to be tricky to follow these kind of changes but we believe we are on track with our present asset allocation model and will stick with that for now.

**RealGrowth Investment Counsel**

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